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SUBJECT: AMBASSADOR MANN, TURKISH OFFICIALS DISCUSS NEXT STEPS ON CASPIAN ENERGY AND THE EAST-WEST ENERGY CORRIDOR

Classified by Economic Counselor Scot Marciel for reasons 1.5 (b) and (d).

11. (C) Summary: Ambassador Steven Mann, State Department Special Representative for Caspian Energy Diplomacy, visited Ankara, December 16-18 to discuss Caspian issues with senior Turkish officials, who confirmed Turkey's commitment to the East-West Energy Corridor and expressed confidence that BTC would be completed, despite managerial problems in Turkey. Turkish officials were optimistic in their appraisal of Turkey's development as an energy hub -- the core of the East-West Energy Corridor. Turkey and Greece will soon announce agreement on the long-awaited natural gas interconnector, opening the door for eventual natural gas exports via Turkey to Europe. Turkey completed successful negotiations with Russia to reduce price and take or pay commitments for Blue Stream and is looking ahead to similar success with Iran. Ambassador Mann emphasized that the aggressive policies of Gazprom and Transneft and of Iran made U.S.-Turkish coordination essential on Caspian energy. Mann said his top priorities in the coming months would be the Aktau-BTC connection and promoting pipeline options from Turkey to Europe; both sides agreed to work closely together in pursuit of these priorities. Turkish officials also expressed interest in the prospect of importing Iraqi natural gas to Turkey and onward to Europe, and TPAO conveyed to Mann its interests in Iraq oil as well as gas, and requested to begin a dialogue with CPA Baghdad. End Summary.

Energy Ministry

12. (C) BTC: Ambassador Mann met December 16 with Energy and Natural Resources Minister Hilmi Guler, who opened by saying that Turkey was not concerned that recent political instability in Georgia and Azerbaijan would threaten completion of the BTC pipeline. The government was aware of BP's concerns about construction delays in Turkey. He recognized how important it was to stay on schedule and pledged that BOTAS would finish the job on time. Ambassador Mann said that the USG continues to strongly support Turkey as an energy hub to Europe. However, Turkey's performance on BTC has broad implications for Turkey and the whole East-West Energy Corridor. Support for future projects, such as Shah Deniz, will be influenced by Turkey's record on BTC construction. We need to ensure that Turkey is the most attractive option. Drawing on BTC Co.'s latest readout, he stressed that his concerns were not with the government's commitment but the performance of BOTAS. Guler complained that BTC conditions on environment and safety make it very tough to complete the work on time. Mann replied that BOTAS knew the conditions when it agreed to the contract.

13. (U) Greece Interconnector: Guler announced that just minutes before the meeting, Turkey and Greece reached agreement on the natural gas interconnector and that the signing would take place the week of December 22. Mann warmly welcomed this and proposed a USG announcement welcoming the agreement once it had been firmly emplaced.

14. (C) Turkmenistan: Guler said that Turkey remains very interested in Turkmen gas, because the price is the most attractive in the region. Right now, he pointed out, Turkey gets gas from Turkmenistan, but it comes via Russia at a much higher price. Ambassador Mann noted that we could have built a trans-Caspian Pipeline, but for Niyazov, whose fears of Russia were at the heart of the pipeline's failures. A Niyazov regime makes it impossible to expect progress with Turkmenistan on Caspian energy. Guler responded that Turkey has some good cards to play with Niyazov and would like to work together with the U.S. on this option. Mann expressed skepticism and stated that, while US support in principle for a Trans-Caspian line remains unchanged, he would not waste his time on trying to craft a new deal with the Turkmen leader.

15. (C) Kazakhstan: Turkey is very positive about Kazakhstan, Guler remarked, especially Turkish exploration

there, and is hopeful that Kazakhstan will be in the BTC coalition. Ambassador Mann agreed, pointing out that it makes economic sense for Kazakhstan, but we need to overcome the problem of the Kazakh and Azeri regimes seeking to lock up a monopoly on transport across the Caspian. Mann pledged to work together with Turkey to push this issue forward.

16. (U) Iraq: Guler said that Turkey is interested in Iraq gas exports via Turkey. Mann noted that his recent involvement in Iraq was centered on the UN Oil for Food program, but offered an observation that Iraqi gas was years in the future as an issue. Guler pressed for information on Kirkuk-Yumirtaluk and noted that Turkey has made several offers (with no response) to assist with pipeline security issues in northern Iraq. Ambassador Mann pledged to convey the Minister's request for formal consultations to CPA.

17. (U) Guler noted that Turkey has exported power to Iraq and wants to do more. For example, Turkey could dedicate the production of certain coal-fired plants in Turkey for Iraq. Another alternative would be to send some mobile generator stations to Iraq. The big advantage was that these generators use fuel oil, which is in surplus in Iraq. He added that Turkey is ready to send fresh water by rail to Iraq.

18. (C) Iran: Turkey is in discussions with Iran about reducing the price it pays for imported gas and reducing the take or pay volume, just as it did with Russia. Guler remarked that Iran has been very active in seeking contracts in Europe. Referring to the prospect of gas pipelines from Turkey to Europe, Guler said we could use their expectations to our advantage in the negotiations. Mann responded that Iran remains a sharp issue for the U.S. and pointed out that it is not just policy but a matter of U.S. law. He said that it was good to seek a price reduction, and the USG understood that the GOT would use Iran's Europe ambitions to its tactical advantage in the negotiations, but it was important to go no further. He warned Guler not to make a commitment to transship Iran's gas because that would raise ILSA issues and call into question US support for the Turkey-Greece interconnector.

19. (U) BTC: In a meeting December 17th, Energy Under Secretary Demirbilek affirmed that BTC and the Shah Deniz

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pipeline were top priorities for Turkey. He said that delays in BTC construction were one of many energy problems the AK government inherited. The Ministry has been in talks with the subcontractors to BOTAS and all but one has signed recovery plans to bring the construction back on schedule. Demirbilek said he has stressed to the subcontractors that they get all logistical preparations taken care of so that they can resume operations in March, after the winter season ends, with no restraints.

10. (SBU) Greece: Demirbilek said that relations with Greece have been improving in general, and BOTAS, in particular, was encouraged after successfully negotiating a price reduction with Russia. Price had been the sticking point, but Greece agreed to pay the average cost of Turkey's gas imports plus a USD 10-15 transit fee. The final price will not be known until the Shah Deniz gas begins to arrive in Turkey. Greece also was considering a Turkish proposal to increase the size of the pipeline from 36 to 42 inches.

11. (C) Mann said his emphasis in 2004 would be on Aktau-BTC and the Balkans, specifically the three options for gas transit from Turkey to Europe (via Greece to Italy, via Greece to Macedonia and Albania, and via Bulgaria and Romania to Central Europe). He noted that the Baumgarten option was not viable until Turkey's contract for Russian gas via the west pipeline expired in 2012. Demirbilek argued that Turkey would extend the pipeline and continue to import gas from Russia; otherwise, Russia would use the pipeline to compete with Turkey and deliver Russian gas to Greece and Italy. Mann countered that Turkey could reverse the flow and use the pipeline for deliveries to Hungary.

12. (U) Domestic Gas Market: Another problem that the AK government inherited, according to Demirbilek, was the restructuring of the domestic energy market. He said that the current plan will not work and he plans to work hard over the next six months to arrive at a solution, including amendments to the gas and electricity laws. (Note: the laws mandated liberalization but have gone largely unimplemented.) Reform is especially important to prepare the market for the influx of Shah Deniz gas, he said.

113. (C) Russian Energy Policy: Ambassador Mann met December 17 with Deputy Under Secretary Kilic, who emphasized Turkey's confidence that BTC is irreversible. Kilic said the government is looking ahead to what he considers the more important issue of natural gas. Mann emphasized that BTC was still important because how well the project is accomplished will affect confidence about other Caspian projects. Ambassador Mann expressed his concern about increased Gazprom and Transneft activism, including Niyazov's 25-year gas deal with Russia, the corrupt and distasteful Georgian gas deal in July, and Russian attempts to reverse Odessa-Brody. Kilic responded supportively. He and Mann agreed that the most promising immediate area for US-Turkish cooperation is in making final an Aktau-BTC agreement, and they agreed to a joint negotiating mission with the ABTC parties in the first quarter of 2004. Kilic urged that we not leave Turkmenistan out of our considerations. Mann responded along skeptical lines, as in the Guler meeting.

114. (SBU) Greece: On natural gas, Kilic said that there has been real progress. The Greece-Turkey Interconnector agreement will be an important step. He noted that Greece sees itself as a regional hub and has been promoting Caspian gas within the EU, which is showing signs of growing interest. He urged that we keep all three options for pipelines to Europe open. Kilic urged that Turkey, Greece and the U.S. jointly talk to consumer countries in the Balkans and Europe; Mann agreed to consult with our embassies in the region and consider this.

115. (C) Iran: Kilic said Turkey wants to make itself a transit hub for Iran's massive gas reserves but recognized that under current conditions not much can be done. He said Turkey wants to keep its options open with Iran to keep Teheran on the hook. He added that Greece and the EU see Iran as an important supplier to Europe and Iran has been very aggressive in seeking contracts in Europe. Mann stressed that an agreement between Turkey and Iran to transship Iranian gas would mean the U.S. could not support the interconnector, and would open the door to ILSA problems. As a fundamental point, we need Greece and Turkey to reaffirm the priority of Caspian gas. Kilic asked Mann to stress this with Greece and the EU.

116. (C) Kilic pointed out that Iraq gas could be an alternative to Iran. He said Turkish firms have contracts from many years back for Iraqi gas and he promised to give more details in a non paper, which Mann said he would send to Baghdad for comment. (Embassy will e-mail the text to CBED.)

BOTAS

117. (C) On December 18, Ambassador Mann met with Mehmet Bilgic, DG of BOTAS, the state natural gas and pipeline monopoly, and construction manager for the Turkey portion of BTC. Bilgic remarked that Turkey has made real progress in reducing energy costs to the population. The most positive result of lower prices has been that consumption of natural gas has increased and more consumers are switching from coal to natural gas -- where it is available. This has helped to reduce air pollution in Turkey's big cities. He said that BOTAS successfully re-negotiated the Blue Stream deal with Gazprom and to reduce the price and take or pay commitment. He said that Iran would be next -- Turkey will seek similar reductions and expects to complete a deal in January 2004. Further down the road, BOTAS will try to reduce expensive LNG contracts with Algeria and Nigeria.

118. (U) Iraq: BOTAS is looking to Iraq as a future, cheap source of natural gas -- both for domestic consumption and to meet rising demand in Europe. In a non-paper prepared for Ambassador Mann, BOTAS and the MFA explained Turkey's previous efforts in the late 1990s to develop natural gas imports from Iraq and their hope that fields in northern Iraq can be developed and pipelines built to begin shipping gas into the Turkish grid by 2009. Bilgic explained that development of the fields would depend on the private sector but would not involve a large investment -- much of the gas would be associated output from present oil fields -- and BOTAS would lead the effort to construct the connecting pipeline, which would run parallel to the Kirkuk-Ceyhan oil pipeline.

119. (SBU) Turning to the Kirkuk oil pipeline, Bilgic said

that BOTAS had made repeated attempts to offer Turkish assistance on repairing and securing the Kirkuk pipeline. Ambassador Mann pledged to pass on the Turkish offer. Bilgic said that it would be essential to include the local population in the security measures. He noted that without the pipeline, oil and products are transported by truck -- bringing lots of money to the locals. The pipeline locals -- on both sides of the border -- profit from the transport by truck. Restoration of the pipeline will mean that most of that money will go to central government.

120. (U) BTC: Bilgic offered a detailed explanation of the problems behind BTC construction delays in Turkey and pledged to fix the problems. He said the main problem is managerial.

First, the Turkish subcontractors were not ready for the very stringent IBRD guidelines on resettlement and land acquisition -- Turkish law is much easier. This caused a delay at the start as securing the right of way was delayed. In addition, BTC's health, safety and environmental standards are higher than the contractors were accustomed to, and the subcontractors have been passive in addressing these issues. Bilgic added that BOTAS failed to understand its responsibility as the prime contractor, which forced BTC to step in to keep the project on track. Finally, BTC hiring requirements meant that a number of expatriate managers were hired, but they did not have a deep commitment to the project. BOTAS will replace many of the expats with BOTAS managers. He said BOTAS's attitude has changed: "we must deliver, not complain." He added that agreements have been reached with all but one of the subcontractors to get the project back on schedule. Mann stressed the pressing need to repair the deficits and get the project back on track.

121. (U) Greece: Turning to the deal with Greece on a natural gas interconnector, Bilgic explained that a few issues remain to be settled, but a senior Greek official will come to Ankara December 23 to sign the final agreement. He added that Turkey appreciates U.S. support for this effort. To make this project a success, BOTAS must address the issue of reliability, and storage is the key. Gazprom is the competition and they have an outstanding track record of reliability. BOTAS has gotten a green light from the IBRD to help finance a 1.5 bcm storage facility that can be expanded to 5 bcm.

TPAO

122. (SBU) TPAO head Osman Dinc pulled Mann aside during lunch at DCM's and conveyed a strategy outline for TPAO exploration and development in Iraq, centering on the following issues:

- concluding an agreement on the Gharraf oil field on the basis of an existing PSA;
- developing an Iraq-Turkey gas export project involving fields north of Baghdad;
- joining large field consortia, e.g. West Qurna and Majnoon;
- exploring in Blocks one and four in the western and southern deserts.

Mann agreed to convey the information to CPA Baghdad along with Dinc's request to come to Baghdad for detailed discussions with Ministry of Oil and CPA. Copy of Dinc's presentation will be scanned and sent to CPA Baghdad via e-mail from EB/CBED.

Baghdad minimize considered.

Ambassador Mann cleared this cable.
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